Testimony in Support of S.B. 21, S.B 27, S.B. 28, and S.B. 29

Committee on Finance, Revenue, and Bonding

March 3, 2021

Dear Senator Fonfara, Representative Scanlon, Senator Martin, Representative Cheeseman, and members of the Finance, Revenue and Bonding Committee:

Connecticut Voices for Children (CT Voices) supports S.B. 21, An Act Concerning a State-Wide Property Tax, S.B. 27, An Act Increasing and Expanding the Property Tax Credit, S.B. 28, An Act Establishing a Capital Gains Surcharge, and S.B. 29, An Act Concerning the Earned Income Tax Credit.

In this testimony, we review why we support these tax increases, and also the proposed tax cuts for working- and middle-class families, and, where appropriate, we provide recommendations for strengthening the proposals.

Raising Revenue Through Tax Increases on the Wealthy

In a brief report we published this week, "Connecticut's 2022 Tax Incidence Report: A High-Level Overview and Comparison to the 2014 Report," we show two key findings that are presented in **Table 1** and reviewed below:

Connecticut's unfair tax system continues to exacerbate income inequality. Using data from the DRS' annual income tax report for 2019, the average wealthy family in Connecticut has a pre-tax income of nearly $3.1 million, which is 137-times greater than the pre-tax income of $22,500 for the average working-class family. Using data from the DRS' new tax incidence report, a family with an income of $3.1 million has an effective state and local tax rate of 7.08 percent, compared to 25.96 percent for a family with an income of $22,500. As a result of Connecticut's unfair tax system, the average wealthy family's post-tax income increases to 171.6-times greater than the post-tax income of the working-class family, which is a 34.6-point increase in the income inequality ratio that was already exceptionally high.

A similar process occurs for the average middle-class family. Using the same data sources, the average wealthy family has a pre-tax income that is 31.7-times greater than the pre-tax income of $97,400 for the average middle-class family. Moreover, the average wealthy family has an effective state and local tax rate of 7.08 percent, compared to 15.50 percent for a family with an income of $97,400. As a result of Connecticut's unfair tax system, the average wealthy family's post-tax income increases to 34.8-times greater than the post-tax income of the middle-class family, which is a 3.1-point increase in the income inequality ratio that was already high.

Table 1. Impact of Connecticut's Unfair—or Regressive—Tax System

Average Family / Median Household	Pre-Tax Income	Pre-Tax Inequality Ratio	Effective State & Local Tax Rate	Post-Tax Income	Post-Tax Inequality Ratio	Change in Inequality Ratio
Average Wealthy Family	$3,083,600	-	7.08%	$2,865,300	-	-
Average Upper-Class Family	$352,800	**8.7x**	10.35%	$316,300	**9.1x**	**+0.4**
Average Middle-Class Family	$97,400	**31.7x**	15.50%	$82,300	**34.8x**	**+3.1**
Average Working-Class Family	$22,500	**137.0x**	25.96%	$16,700	**171.6x**	**+34.6**
Average Wealthy Family	$3,083,600	-	7.08%	$2,865,300	-	-
Median White Household	$85,800	**35.9x**	15.50%	$72,500	**39.5x**	**+3.6**
Median Latino/a/x Household	$49,200	**62.7x**	19.55%	$39,600	**72.4x**	**+9.7**
Median Black Household	$48,900	**63.1x**	19.55%	$39,300	**72.9x**	**+9.8**

*Data from CT DRS, U.S. Census Bureau, and author's calculations. Pre- and post-tax incomes rounded to nearest hundred.

Connecticut's unfair tax system continues to exacerbate the racial income gap. Adding data from the U.S. Census Bureau, the average wealthy family in Connecticut has a pre-tax income that is 63.1-times greater than the pre-tax income of $48,900 for the median Black household. Moreover, the average wealthy family has an effective tax rate of 7.08 percent, compared to 19.55 percent for a household with an income of $48,900. As a result of Connecticut's unfair tax system, the average wealthy family's post-tax income increases to 72.9-times greater than the post-tax income of the median Black household, which is a 9.8-point increase in the income inequality ratio that was already exceptionally high due in large part to a substantial racial income gap. In comparison, Connecticut's unfair tax system increases the income inequality ratio by 3.6 points for the median white household, which has an effective state and local tax rate of 15.50 percent.[1]

To address Connecticut's historic level of income and wealth inequality, substantial racial income and wealth gaps, and an unfair tax system that exacerbates those problems, we have recommended in several reports that policymakers raise income and wealth taxes on the wealthy.[2] Those recommendations have included establishing a progressive state-wide property tax and establishing a progressive capital gains surcharge, which is what S.B. 21 and S.B. 28 would do, respectively.

S.B. 21: An Act Concerning a State-Wide Property Tax on Certain Residential Real Property

S.B. 21 would "establish a state-wide property tax at the rate of 2 mills on residential real property with an assessed value of greater than one million two hundred thousand dollars." In simple terms, this bill would establish a 0.2 percent tax on 70 percent of the market value of residential property worth over $1.7 million. As we reviewed in our 2020 tax report, there are several benefits to establishing a well-designed statewide property tax on high-value properties or mansions. Most notably:

- It would provide a substantial and stable source of revenue that is exempt from the volatility cap.
- It would add a fair component to Connecticut's unfair tax system because it would only apply to wealthy families.
- It would not contribute to millionaire tax flight because "houses can't be easily moved across borders to avoid taxation."
- It would be easy to implement relative to many other new wealth taxes because it would simply add a progressive statewide component to the regressive local property tax system already in place and therefore would not require substantial new administrative support or a substantial period of time to implement.[3]

While we support S.B. 21, we recommend that policymakers consider addressing the following design issues:

- As currently written, the bill includes a tax cliff. Residential real property with an assessed value of $1.2 million is not taxed, but if the assessed value increases to $1,200,001 the property is taxed $24,000. To avoid this tax cliff and any potential valuation issues that may arise in response, policymakers could revise the bill so that the tax only applies to the portion of the assessed value *above* a certain threshold. Moreover, to generate the same amount of revenue as the current proposal, policymakers could make two other changes: (1) lower the threshold to apply, for example, to the portion of the assessed value of property worth over $1.05 million (i.e., a market value greater than $1.5 million); and (2) increase the applicable tax rate.
- As currently written, the bill has the potential to increase the tax burden on working- and middle-class families. Working- and middle-class families that live in apartments in buildings that have an assessed value of more than $1.2 million would likely pay some or all of the new tax indirectly through higher rent. To avoid this indirect tax increase, policymakers could revise the bill so that the tax only applies to owner-occupied homes and rental homes and apartments that are individually valued above the applicable tax threshold.

S.B. 28: An Act Establishing a Capital Gains Surcharge

S.B. 28 would establish a one percent surcharge on capital gains for single tax filers making more than $500,000 and married filers making more than $1 million a year. As we detail in our 2020 tax report, there are several benefits to establishing a capital gains surcharge. Most notably:

- It would provide a substantial source of revenue.
- It would strengthen one of the fairest components of Connecticut's unfair tax system (i.e., the income tax) because it would be based on ability to pay and would only apply to wealthy families.[4]

An Alternative Progressive Revenue Source: Closing CT's $2.6 Billion Income Tax Gap

Policymakers could provide increased funding for the Department of Revenue Services (DRS) in order to close or reduce Connecticut's estimated $2.6 billion annual income tax gap, which would raise revenue in a progressive manner without raising statutory tax rates. While we support S.B. 28, we understand that there is opposition to raising statutory tax rates on the wealthy. Therefore, as detailed in our January report, we recommend that policymakers consider supporting another progressive revenue source: closing or reducing Connecticut's estimated $2.6 billion income tax gap. An income tax gap is the difference between the income tax owed to the government and the income tax paid, and the Internal Revenue Service (IRS) highlights two key causes of the federal income tax gap: "opaque income sources that accrue disproportionately to higher earners" (e.g., business income and rental income) and the IRS's limited resources to ensure tax compliance.

The problem of a tax gap that primarily benefits the wealthy due to limited information reporting appears to be even greater in Connecticut than in the U.S. as a whole because Connecticut has a higher share of "opaque income sources that accrue disproportionately to higher earners." Moreover, like the IRS, the DRS' staff has decreased by 25 percent of over the last two decades, which has almost certainly diminished Connecticut's tax compliance capacity and is especially important considering the state's above average reliance on "opaque income sources that accrue disproportionately to higher earners."

Two other developments are also notable. First, the DRS has routinely administered tax amnesty programs, which is an acknowledgement that Connecticut has a tax gap. For example, to generate an estimated $40 million in FY 2022, the current budget spends $1.1 million to establish "a tax amnesty program for individuals, businesses, or other taxpayers that owe Connecticut state taxes." Second, like the IRS, the DRS has made clear that increasing its resources would work to decrease Connecticut's tax gap. Most notably, the FY23 budget provides the DRS an additional $1.13 million in funding for the "Data Analytics team" that is "responsible for developing data-centric compliance projects" and that "will transform how DRS conducts audits and debt collections by creating early intervention methods which ensure full collection of the tax that is due." The state then estimates that this increase in funding will generate $40 million a year—that is, a $35 return for each $1 spent. This is substantially greater than the IRS's estimate of a $4 direct return for the each additional $1 spent, and it suggests that Connecticut could collect substantially more revenue by further increasing the DRS's tax compliance capacity.[5]

Cutting Taxes for Working- and Middle-Class Families

In a brief report we published this week, "Connecticut's 2022 Tax Incidence Report: A High-Level Overview and Comparison to the 2014 Report," we show two key findings that are presented in **Table 1** and that we review in more detail in our accompanying testimony for S.B. 21 and S.B. 28.

- Connecticut's unfair tax system continues to exacerbate income inequality.
- Connecticut's unfair tax system continues to exacerbate the racial income gap.[6]

Table 1. Impact of Connecticut's Unfair—or Regressive—Tax System

Average Family / Median Household	Pre-Tax Income	Pre-Tax Inequality Ratio	Effective State & Local Tax Rate	Post-Tax Income	Post-Tax Inequality Ratio	Change in Inequality Ratio
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Average Wealthy Family	$3,083,600	-	7.08%	$2,865,300	-	-
Median White Household	$85,800	**35.9x**	15.50%	$72,500	**39.5x**	**+3.6**
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Median Black Household	$48,900	**63.1x**	19.55%	$39,300	**72.9x**	**+9.8**

*Data from CT DRS, U.S. Census Bureau, and author's calculations. Pre- and post-tax incomes rounded to nearest hundred.

To address Connecticut's historic level of income and wealth inequality, substantial racial income and wealth gaps, and an unfair tax system that exacerbates those problems, we have recommended in several reports that policymakers cut taxes for working- and middle-class families.[7] Those recommendations have included both strengthening the Connecticut property tax credit (CT PTC) and increasing the Connecticut earned income tax credit (CT EITC), which is what S.B. 27 and S.B. 29 would do, respectively.

S.B. 27: An Act Increasing and Expanding the Property Tax Credit

S.B. 27 would "(1) increase the amount of the property tax credit to four hundred dollars, (2) reduce the recapture percentage from fifteen per cent to ten per cent, and (3) adjust the recapture provisions." In simple terms, the bill would increase the maximum property tax credit, which would benefit working- and middle-class families, and it would reduce the phase out of the credit, which would benefit middle-class families. As we explained in our 2020 tax report, there are several benefits to expanding the CT PTC and improving its design. Most notably:

- It would strengthen one of the fairest components of Connecticut's unfair tax system (i.e., the income tax) because it is based on income level and property taxes paid and would benefit working- and middle-class families, who have high effective tax rates
- It would boost economic growth.[8]

For comparison, the governor's proposal would restore the CT PTC to families that are not seniors or have no dependent and, as **Figure 1** shows, it would increase the maximum credit from $200 to $300, all of which would help many working- and middle-class families. Moreover, as **Figure 2** shows, S.B. 27 would go further in increasing the maximum credit from $200 to $400 and extending the phase out, but it would not restore the credit to families that are not seniors or have no dependent.

While we support S.B. 27 and the governor's proposal, we recommend that policymakers consider addressing the following issues with the CT PTC, which neither proposal would currently change:

The CT PTC is nonrefundable, which hurts working-class families. A "refundable" tax credit is paid to a tax filer if it exceeds their income tax liability, whereas a "nonrefundable" tax credit is capped by the amount of income tax liability. Although many working-class families pay at least $200 in the property tax and meet the necessary income requirements, they do not have enough income tax liability to qualify for the maximum CT PTC and therefore receive either no credit or a reduced credit. For example, a married working-class family that makes $22,500 receives no CT PTC because the family has no income tax liability. If the objective is to offset the high property tax burden in Connecticut, receiving the CT PTC should not depend on income tax liability.

The CT PTC is not available to renters, which especially hurts working-class families. Homeowners pay the property tax directly and potentially qualify for the CT PTC in addition to benefitting from the equity that they build in owing their home. In contrast, renters pay the property tax indirectly and (if they do not own a motor vehicle) they do not qualify for the CT PTC in addition to not building equity. Excluding renters especially hurts working-class families because they are less likely to own a home compared to families in higher income groups.

The CT PTC includes a marriage penalty, which hurts middle-class families. The CT PTC is available to single tax filers that make up to $109,500, which includes more than 90 percent of all single tax filers. In contrast, the CT PTC is only available to married tax filers that make up to $130,500, which includes less than 65 percent of all married tax filers and therefore excludes many middle-class families. S.B. 27 addresses this problem in part by extending the phase out of credit to include more middle-class families. However, the extension applies all tax filers and therefore would include about 95 percent of the single filers, compared to about 75 percent of married filers.

The CT PTC is not indexed to inflation, which hurts working- and middle-class families over time. Along with other major components of the income tax—the exemption, brackets, and personal credit—the CT PTC is not indexed to inflation and therefore its real value decreases each year.

If policymakers want to further improve the CT PTC they could make any one or all of the following changes: (1) make the CT PTC refundable; (2) make the CT PTC available to renters; (3) remove the marriage penalty, and (4) inflation index the CT PTC.

Figure 1.
CT Property Tax Credit:
Current Law and Governor's Proposal

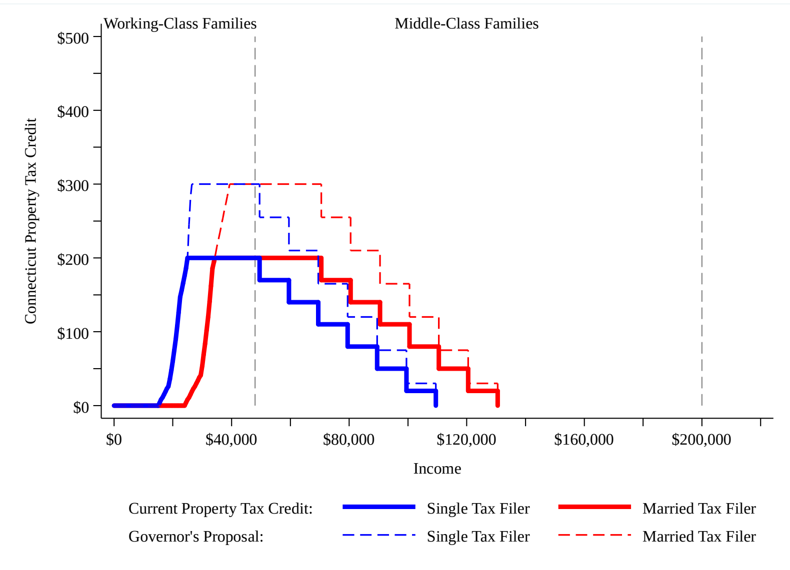
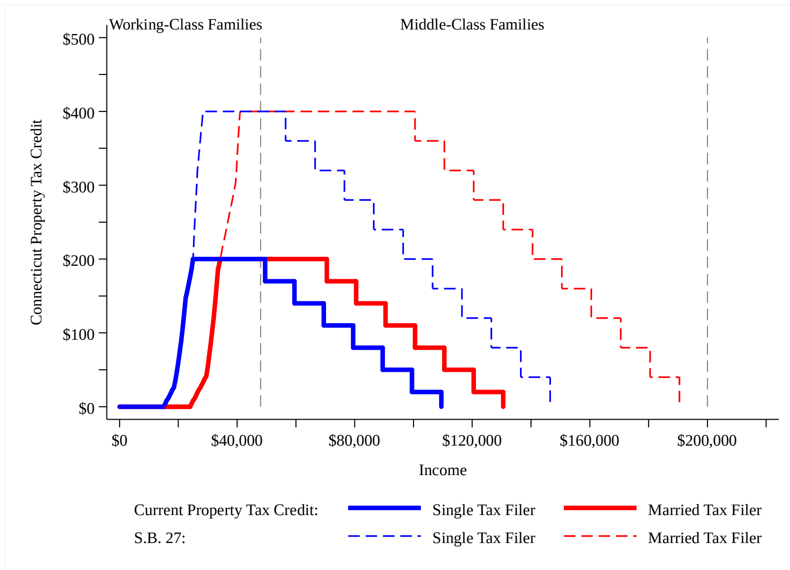


Figure 2.
CT Property Tax Credit:
Current Law and S.B. 27



*Data from CT DRS, CT Governor's office, CT General Assembly, and author's calculations.

S.B. 29: An Act Concerning the Earned Income Tax Credit

S.B. 29 would increase the Connecticut earned income tax credit (CT ETIC) from 30.5 percent to 41.5 percent beginning in January 2022. In simple terms, this would provide a tax cut for many working-class families. As we explained in our 2020 tax report, there are several benefits to increasing the CT EITC. Most notably:

- It would strengthen one of the fairest components of Connecticut's unfair tax system (i.e., the income tax) because the tax credit is based on income level and number of children and would benefit working-class families, who have the highest effective tax rate.
- It would boost economic growth.[9]

While we strongly support S.B. 29, it is important to highlight that increasing the CT EITC is not a substitute for establishing the Connecticut Child Tax Credit (CT CTC). As **Figure 3** and **Figure 4** show, the CT EITC primarily helps working-class families, whereas the CT CTC that passed the Finance, Revenue, and Bonding Committee last year would help both working-class families and middle-class families. This is essential because, as addressed earlier, Connecticut's unfair tax system exacerbates income inequality for working-class families and middle-class families.

Figure 3.
Connecticut Earned Income Tax Credit

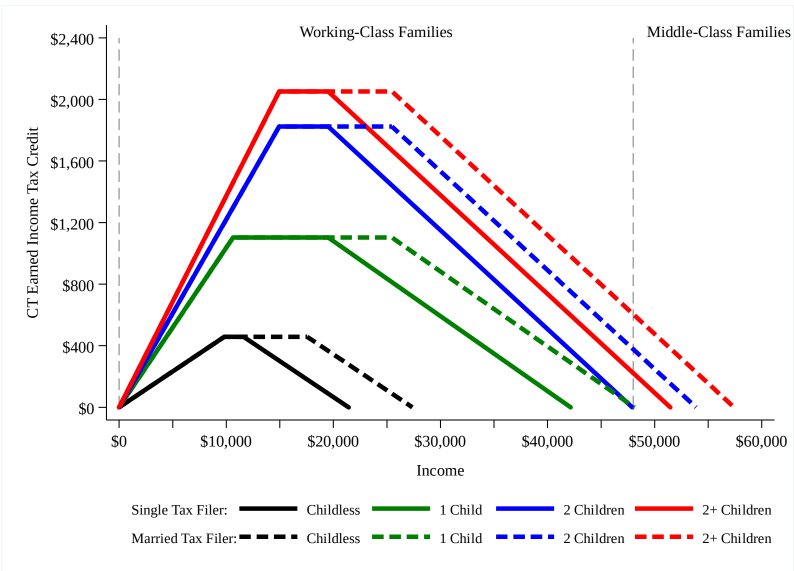
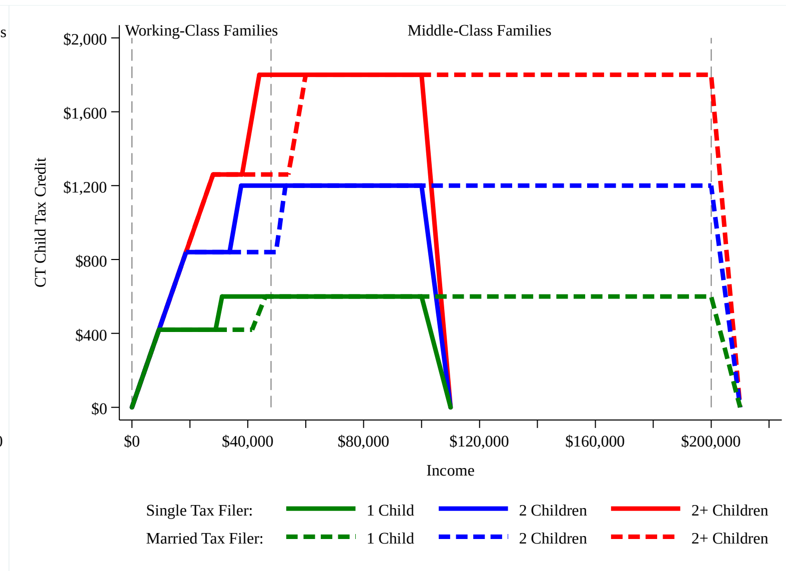


Figure 4.
Proposed Connecticut Child Tax Credit



*Data from CT DRS, Internal Revenue Service, CT General Assembly, and author's calculations.

Even if policymakers increase the CT EITC, we recommend that they also establish the CT CTC. As detailed in our February 2022 tax report, "The Case for the Connecticut Child Tax Credit," there are several reasons to establish the CT CTC beyond those addressed above.

JUST FACTS

- At an average of $16,990 a year, raising a child in Connecticut is more expensive than almost anywhere else in the country. Connecticut is the only high cost of living state with an income tax that does not adjust for family size or child care expenses to help offset the high and growing cost of raising children.

- 86% of the taxpayers that leave CT make less than **$200,000 a year**, meaning the state is primarily losing working- and middle-class families, Connecticut's average middle-class family with no children pays nearly twice as much in the federal income tax than the state income tax. However, due to the federal CTC and lack of a state CTC, the same family with two children pays nearly as much in the state income tax as the federal income tax.

- Wealthy CT residents often migrate to states with similar or even higher top state income tax rates. NY is the most popular destination to migrate to from CT, and CA is the 4th highest destination; both states have higher top income tax rates.

- However, NY and CA adjust for family size and child care expenses; the average middle-class family with two children and childcare expenses would pay ***less*** in the state income tax in NY and CA than CT. If Connecticut's average middle-class family moved to NY or CT, its state income tax burden would be lower due to a tax cut of up to $750 per child, or up to $590 per child, respectively.[10]

Thank you for your consideration,

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References

[1] Patrick R. O'Brien. (2022). "Connecticut's 2022 Tax Incidence Report: A High-Level Overview and Comparison to the 2014 Report." Connecticut Voices for Children. Accessed at

[2] Patrick R. O'Brien and Daniel Curtis. (2021). "Advancing Economic Justice Through Tax Reform." Connecticut Voices for Children; Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children.

[3] Patrick R. O'Brien and Daniel Curtis. (2021). "Advancing Economic Justice Through Tax Reform." Connecticut Voices for Children.

[4] Ibid.

[5] Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children.

[6] Patrick R. O'Brien. (2022). "Connecticut's 2022 Tax Incidence Report: A High-Level Overview and Comparison to the 2014 Report." Connecticut Voices for Children. Accessed at

[7] Patrick R. O'Brien and Daniel Curtis. (2021). "Advancing Economic Justice Through Tax Reform." Connecticut Voices for Children; Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children.

[8] Patrick R. O'Brien and Daniel Curtis. (2021). "Advancing Economic Justice Through Tax Reform." Connecticut Voices for Children.

[9] Ibid.

[10] Patrick R. O'Brien (2022). "The Case for the Connecticut Child Tax Credit." Connecticut Voices for Children.